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REBUILDING THE PRIVATE SECTOR

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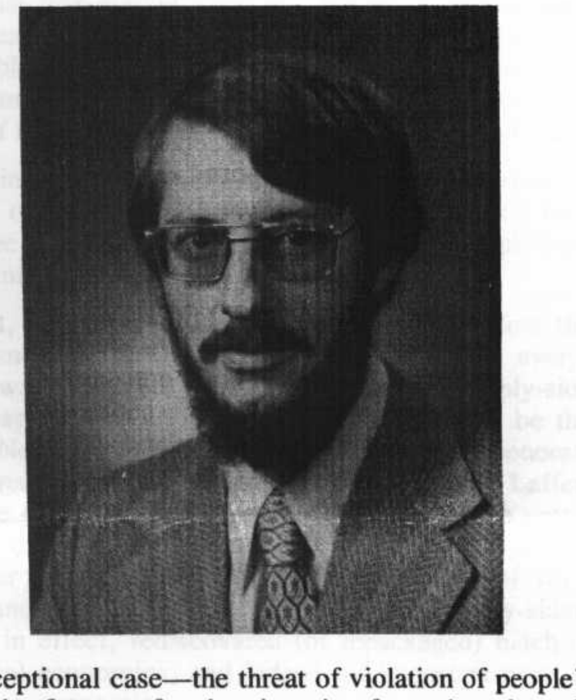

To help put my approach to today's topic in perspective, I'd like to ask you to think about what that key phrase, "the private sector," really means. Obviously, it's used to distinguish certain types of activities from others which belong to something called "the public sector."

What this terminology implies is that our society is divided up into two spheres of implicitly equal importance—some activities are relegated to one sector, others to the other sector, and the choice is probably made as a matter of pragmatic convenience.

Contrast that view with the natural law/individual rights/limited government view. This view says that the normal condition of people in society is voluntary interaction, whether it is through business, family, church, or charitable activities. Only when it comes to an exceptional case—the threat of violation of people's rights by force or fraud or invasion from abroad—only then do we turn to an agency of controlled force, government, to deal with the problem. Government, on this view, is limited to the specific function of protecting individual rights and has no other function.

So from this perspective, the term "public sector" is a blank check for big government and a denial of the basic principle of limited government. By using that term you give away the store to those who want to use the state to accomplish their goals.

This country seems to be at an historic turning point. Intellectually, the past 20 years or so have witnessed a major upheaval in the world of ideas. The prevailing collectivist thinking has undergone very serious challenge. In philosophy, the dominance of positivist, relativist thinking has been challenged by a new gen-

im•pri•mis (ĭm-prȳ-mĭs) adv. In the first place. Middle English, from Latin *in primis,* among the first (things)....

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eration of philosophers who have taken a fresh look at such ideas as natural law, natural rights, and justice as meaningful concepts. In particular, the work of Harvard's libertarian philosopher Robert Nozick has forced the intellectual community to sit up and take notice.

In economics, the dominance of the central planning ideas espoused by John Maynard Keynes has been broken. I think it's fair to say that the majority of the economists under the age of 40 today are favorable to the free market and quite skeptical of the government. Whether they reach their conclusions empirically—like those in the University of Chicago/UCLA tradition—or deductively, as do those in the Austrian tradition of Ludwig von Mises—the result is a renewed appreciation for the marketplace, for competition, for entrepreneurship, and a healthy distrust of government—whether in the form of macroeconomic manipulation or of detailed command-and-control regulation in millions of workplaces.

In political science, as well, there is a very promising school of thought called the public choice approach, which began at Virginia Polytechnic Insitute. Its basic idea is to examine how government actually works when it tries to do things. For decades people kept proposing government action as the solution to various problems, as if government were somehow a utopian institution run by people dedicated solely to the betterment of society, rather than by very real human beings pursuing their own interests. The public-choice people have provided powerful insights into the reasons *why* most of the attempts to solve problems via government have failed.

How to Market Ideas

So the intellectual groundwork has been laid—in philosophy, economics, and political science—for a fundamental rethinking of the role of government in our society. Obviously, it takes time for ideas to filter out of the books and journals of the scholars and end up reshaping public policies.

What people did in 1980 was to elect a new president who echoed their doubts of big government and to throw out a lot of big-spending liberal congressmen who symbolized the problem. Unfortunately it is not at all clear that those who voted this way in 1980 had any clear idea how bad the problems of our over-governed society really are and what it might take to put things right. So it looks as if some of them are already getting cold feet about making basic changes in the welfare state.

This brings me to a very important point of methodology. If we're talking about convincing people of a new way of looking at the role of government in our society, in an important sense we're talking about a problem in the *marketing* of ideas. And a basic principle of marketing is: You can't replace something with nothing. Most people do think that, in the abstract, government is too big, and taxes are too high. But when it comes to cutting out a *specific* program or abolishing a *specific* agency, those same people will often balk. Why? Because they don't see any alternative. They know that food stamps were intended to help poor people get enought to eat, and they don't know how that will happen if food stamps are abolished. They know OSHA was created to ensure safe workplaces, and they're afraid of what might happen if it were abolished.

My point is that in order to sell people on shrinking the role of government, we have to give them more than just free-market ideology. We must address their very real doubts and fears by showing them practical, workable *alternatives* to government agencies and programs. Only then can we expect them to support the kind of fundamental restructuring we're talking about.

Having set the stage, let me now turn to specific means of bringing about this restructuring. Let's look at three broad areas of policy emphasis: supply-side economics, privatization, and deregulation.

First, supply-side economics. Last year, before the seriousness of the recession became apparent, everybody was trying to climb on board the supply-side bandwagon. Today, just the reverse seems to be the case. Nevertheless, it remains true that the economic ideas recently advanced by people like Arthur Laffer, George Gilder, Jude Wanniski, and Jack Kemp represent a clean break with the neo-Keynesianism of the postwar period. In fact, with their rediscovery of Say's Law and their stress on incentives, the supply-siders have, in effect, rediscovered (or repackaged) much of classical economics, and indeed, of important parts of Austrian economics.

What the supply-siders hoped to do, via the Reagan Administration, was to set in motion a process which would shrink the role of government and expand the role of individuals and businesses—in other words, to revitalize the private sector relative to the government sector. And despite the wailing and gnashing of teeth coming out of Washington, some important steps in that direction have been initiated.

Supply-Side Goals

The first of these was the tax rate reduction act passed last year. For nearly 70 years we have had what is called a "progressive" income tax. (There's another one of those words which give away the store). Before World War II when the rates most people faced were relatively low and inflation was negligible, the income tax's two most dangerous features were not apparent. Those features are: (1) the disincentive to hard work and entrepreneurship caused by high *marginal* tax rates (which lead people to invest in tax shelters rather than new business ventures), and (2) the built-in inflation premium for government, caused by people being

shifted into higher tax brackets when they get pay raises to keep up with inflation. The result of this second feature was that for every one percent increase in the inflation rate, the federal government's revenue went up by about 1.4 percent. And as long as its revenue increased automatically like that, government had no trouble creating new programs to sop up the tax money. It's no wonder that the fraction of GNP consumed by government at all levels climbed from 19.5 percent in 1948 to 32 percent in 1979.

The 1981 tax legislation was specifically designed to halt this built-in increase. For fiscal years 1982, 1983, and 1984, marginal rates are reduced each year to more or less compensate for bracket creep. And as of FY 1985, tax brackets become indexed, eliminating further bracket creep. So in one stroke, the federal government's source of expansion capital has been cut off, and the focus of the debate has been shifted to *where to cut* rather than *where to spend*.

In addition, reducing high marginal tax rates will make it more worthwhile for entrepreneurs to start new businesses and to expand small businesses into larger ones. Small businesses generate two-thirds of all new jobs, according to studies by MIT professor David Birch. Sole proprietorships and partnerships are taxed at individual income tax rates. And the real lure of turning a new venture into a successful firm is being able to go public while retaining a large fraction of the initial stock. Again, since capital gains taxes are based on individual income tax rates, cutting those high marginal rates will increase the incentives of entrepreneurs.

A second supply-side component, though it's not usually thought of this way, is the New Federalism—President Reagan's plan to shift a number of programs to the states. If it can be enacted, this, too, will shrink the role of government in our country. It will do this not because state and local government are more efficient than the federal government. A government bureaucracy is still a government bureaucracy, whomever it reports to, and public-choice theory gives us no reason to expect government at any level to be truly efficient in the way that profit-making firms are. No, the reason the New Federalism will shrink the size of government is that state and local governments will refuse to fund many of the programs that Washington transfers to them, or will fund them at lower levels.

The reason most social programs were enacted at the federal level is two-fold. First, special-interest groups have much more clout dealing with one legislative body than they do with 50 legislatures. So they're much more likely to get programs established at the federal level, and to get them expanded in size. Second, only the federal government can enact programs without having the resources to pay for them. That makes Washington much more likely than state governments to enact programs that aren't really needed. Being able to print money makes life a lot easier for legislators.

As a result of the tax rate reductions and the prospect of the New Federalism, Congress has been forced into the unprecedented role of actually trying to figure out where to make cuts in the federal budget. And some programs actually are being cut, in real terms, even though the major components of nondefense spending are on automatic pilot, with built-in expansion linked to the rate of inflation. These are the so-called "entitlement" programs—yet another incredible word that gives away the store. But as I said before, we cannot expect sustained public support for large-scale cuts in the scope of government until we can show people practical, nongovernmental alternatives. That's what the second major policy area, privatization, is all about.

Pushing for Privatization

If you ask most economists and political scientists why certain things are usually done by government, they will say that those things are "public goods." They can only be done by government. A public good is something from which everyone benefits, whether or not they have been made to pay for it. Thus, most economists maintain that the only way to get public goods, like national defense, is to have government produce them and make everybody pay for them by means of taxes.

But, if you start applying that rationale to most of the things that local, state, and federal government do—especially local government—you'll find there aren't very many real public goods being produced by government. Picking up garbage, providing parks and tennis courts, recreation programs, and so forth—those are not public goods, those are specific service businesses like dry cleaning and McDonald's hamburgers. They are services that specific individual people use, and for which those individuals can be directly charged. This realization opens the door for looking seriously at ways in which people can pay directly instead of using taxes to get those services, ways in which private profit-making firms or private non-profit organizations could provide many of these things that people now take for granted as government services.

I wrote a book a few years ago, called *Cutting Back City Hall*, that reviews the kinds of areas in which cities and counties all across the country are in fact farming out services to the private sector or leaving particular responsibilities in the hands of private companies and non-profit organizations in the first place. What I found was that when those services are done by private-sector firms, they are almost always done at substantially less cost, and often much more effectively.

Private fire departments, for example, exist in about eight or nine states. The largest one in the country is a

company called Rural Metro Fire Department, Inc., in Scottsdale, Arizona, which provides fire protection in Scottsdale and 13 other Arizona communities at about half the cost of government fire departments. They do the job with about half the number of full-time paid employees, and yet they do it just as effectively as measured by fire law statistics, insurance rates, response time, and all of the other quality indicators. The reason is very simple: They don't have a monopoly on the business. Sheer survival forces the profit-making firm to examine how to mix personnel and equipment and techniques and procedures in the optimum way.

The National Science Foundation in 1976 studied garbage collection in some 1,300 communities. They found unequivocal evidence that where it is done by the private sector, the cost is substantially less than where it is done by municipal sanitation departments. Once again, the profit-making firm has an incentive to do the job in the most efficient way possible. The government monopoly has an incentive to build a bureaucratic empire. It knows no matter what kind of a job it does, barring some real political crisis, it can go in for a bigger budget and the city council will appropriate it, and the taxpayers will have to pay for it.

In California, since Proposition 13 was enacted, we have seen a tremendous growth in contracting out routine things like street sweeping and park maintenance to private profit-making companies—often little cottage industries with just a few entrepreneurs and employees—people with no fancy college degrees, no extensive training, but whose firms can do the job at a substantially lower cost.

There is a city in California north of San Francisco called Rohnert Park that was losing about $60,000 a year on its golf course, until a couple of years ago it signed a deal with a firm called California Golf. California Golf got a long-term lease on the golf course, agreed to make all kinds of capital expenditures to make the course more attractive, and set out to charge fees that would cover the cost of all this, while guaranteeing the city a minimum of $60,000 a year in income plus some percentage of the profits.

Transit Follies

Another example: a few years ago the U.S. Department of Transportation started promoting federal grants for bus stop shelters (at the urging of companies that happened to make those shelters). The various municipal transportation monopolies obediently applied for the grants and began putting in these fancy shelters at $2,500 each. But then a few of those same manufacturing companies said, "Wait a minute, you don't need a federal grant to do this. If you let us put in our shelters and allow us to sell ads on one panel of that glass, we will not only not charge you, we will pay you a percentage of our ad revenue every year." So now, instead of the taxpayers paying for this one way or another, the taxpayers are off the hook because the advertising more than pays the bills.

Of course, transit systems themselves are another tremendous problem for most metropolitan areas. When bus companies started going broke a generation ago, that was telling us that the structure of our metropolitan areas was changing, people were spreading out into suburbs, and it was no longer economically efficient to operate the kind of bus company that had operated before.

But government wouldn't listen to those signals. They bought up these money-losing bus companies, formed them into a single giant municipal monopoly, and when the dust settled, they were losing even more money than before. Then they went in for federal aid for capital grants, figuring that if they bought new buses everybody would ride. That didn't work either, so in the '70s they tapped into the federal till for operating subsidies. And that still didn't work: transit ridership continues to go steadily down, despite gasoline crises, despite everything. More people now walk to work than ride municipal transit systems in this country. Some of these systems have reached the crisis stage. They have not even been able to afford the proper maintenance for years, and now their systems are literally falling apart—none more so than the New York City subway system that was once the world's greatest transit system.

Reason magazine recently ran a major story called "Sell the Subways," a detailed analysis by the head of the NYU economics department of what's wrong with the New York subway system. As a real case in point, he argues that the only way to save the New York subway system is to sell off the pieces to private entrepreneurs and remove any sort of political control over it whatsoever. That way you will allow the market to sort out the different types of service, different levels of fares, and find out what will really work. What you would finally see, I suspect, would be a whole mix of different types of services (mini-buses, vans, jitneys, deregulated taxis, and so forth) responding to ridership needs and doing so in the black.

The same kinds of privatization can be applied to federal government services. There are all kinds of things the federal government does that are essentially businesses which the individual user could be charged for. One good example is air traffic control. Switzerland has always had a private non-profit firm providing air traffic control, with the payments coming directly from the users of the airways, not from the taxpayers. Mexico until recently had exactly that same sort of system. Consulting work done for the U.S. Department of Transportation has produced a detailed plan for how such an approach could be applied in this country. It could rebuild the air traffic control system in the aftermath of last year's strike, faster and better than the

way they are doing it now. Full service could be restored much sooner than the three years now forseen, with a set of private companies doing the job. As it is, the Administration is missing a significant opportunity to make into a business service something that is now a government monopoly.

Cold Feet on Weather Satellites?

Weather service is another example that few people realize is essentially a service business, not a public good that has to be provided by government. The argument that weather forecasts are a public good assumes that every one of us is a direct consumer of weather information. In fact, there are only a few direct consumers, people who have a specific economic need and who would be willing to pay to have that information. They include transportation companies, farmers and agricultural people who have large, well-established organizations of their own which could be the wholesale buyers of weather information, and the news media. Those large, profitable businesses would be perfectly willing to buy that information from whoever produced it, and then to make it available to you and me as part of their overall effort to make their publications or broadcasts a desirable package of information services. So it is completely feasible to privatize that service. COMSAT, the organization that operates many U.S. communications satellites, has already made a proposal to the federal government that it take over the operation of weather satellites on a private basis along with the remote sensing satellite, the Landsat. The Reagan Administration may get cold feet and decide it's too radical to go forward with, but it is in fact a very sensible and practical plan.

Looking beyond this, consider the whole field of information in general, a $10 billion-a-year industry in this country, in which government is the largest single producer. Most of that information the government either gives away for free, or sells at a below-market price. Census data is a good example. The Constitution, of course, requires that there be a census every ten years as a basis for Congressional apportionment. But the Census Bureau today has become a huge information-producing business in many areas that have nothing to do with the constitutional requirement, competing with private information suppliers in providing all kinds of demographic data that companies use in planning their marketing efforts. Why on earth is that a government function? That is a private sector function with private sector customers who want and need the information. That should be privatized.

The General Accounting Office of the U.S. Congress has studied 17 federal government operations that have private sector counterparts. Across the board they found, just as public-choice economic theory would predict, that the federal government operations cost dramatically more than the equivalent private sector operations.

One more potential area of privatization, a very significant one: the federal government is the largest landholder in the United States. It owns 775 million acres, or over one-third of all the land area in the United States, including 63 percent of all the land in the 13 Western states. Our theory would predict that government bureaucracies which administer that land would be very inefficient managers of it, and there is a host of books and studies that document just how badly the U.S. Forest Service, the Bureau of Land Management, and the other agencies have in fact done with this responsibility. Now, proposals are surfacing from the President's Council of Economic Advisors that the federal government should start selling off that land, placing it into the efficient hands of private firms or private non-profit organizations like the Nature Conservancy, and using the proceeds of such sales to begin reducing the national debt.

There is a precedent for this approach. In 1825 Daniel Webster introduced legislation to sell federal lands to pay off the Revolutionary War debt. Within six years the entire debt of the federal government was paid off from land sales, and they even ran a surplus which they then distributed to the states.

The Reagan Administration in February 1982 established a Property Review Board to inventory and evaluate the federal lands and see what could be sold off. The U.S. General Services Administration has put together a preliminary list of surplus federal properties, properties with an estimated market value of $100 billion according to the American Society of Appraisers. An aide to Senator Charles Percy of Illinois has estimated that selling off just 10 million acres out of the BLM's lands could bring in as much as $200 billion, or about one-fifth of the total national debt at this time.

Third Front: Deregulation

The third major policy area essential for rebuilding the private sector is deregulation. On the local level this means re-examining licensing laws and regulations. On the state level it primarily concerns public utility monopolies and regulations. On the federal level it means all of the Washington-based regulatory agencies.

Licensing laws in the localities originally were enacted to protect consumers from unqualified people. But countless studies have now demonstrated that these laws have important negative effects, such as denying newcomers entry to various fields and restricting the choices available to consumers.

In most of our cities, for example, government has artificially restricted the number of taxicabs that can operate. In Washington, D.C., which has no such restriction, there are approximately 10 times the number of cabs per capita as there are in most other major cities. This indicates that the market demand for

taxi service is actually much greater than we would assume by looking at the cities where restrictive licensing is in effect. Taxi driving, a natural point of entry into the productive economy for low-income, unskilled people, many of whom are minorities, is therefore closed off by the kind of licensing laws and regulations that we have in most cities. A logical way of opening up new job opportunities, as well as providing better transportation, is to abolish those taxi licensing laws—to allow anybody who has a driver's license and insurance to carry people for hire in his own car.

The same principle applies in all sorts of skilled occupations like barbering and manicuring, midwives, denturists, paralegals. When government says that you need a thousand hours of training to be a manicurist, it is denying ordinary people the opportunity to go into such fields and build their own little businesses. If we did away with those regulations and allowed the market to provide people with information about who's good and who's not good, we would have all kinds of new job opportunities. The same thing applies even at the level of the highly skilled professions like doctors and lawyers.

At the state level, meanwhile, we are seeing some fascinating challenges to the long-established orthodoxy about public utility companies, suppliers of gas and electric and telephone services. Is it in fact self-evident, as many people assume, that a given geographic area must have one and only one electric utility company in order to provide efficient service on an economically viable basis for the company? Is monopoly natural in this field, or would we find that it's really competition that is natural if only the government would establish the right set of rules and then step back and let the market operate? *Reason* recently did a major study of one American city, Lubbock, Texas, where two power companies serve the same market and everyone benefits. I don't know anybody who likes to have to deal only with the monopoly telephone company or the monopoly gas company, and if you can show people that there are competitive alternatives available, you will have a very powerful consumer issue.

Finally, there are the federal regulatory agencies. At the Reason Foundation we did a book called *Instead of Regulation,* bringing together experts to study ten major federal regulatory agencies. The study looks at questions like whether these agencies are really necessary, what they cost, whether there are practical private-sector alternatives that could substitute for one or all of them.

We believe that there is indeed such an alternative. The agencies are of two general types. The economic regulatory agencies like the CAB, the ICC, and the Federal Trade Commission all rest on the fallacious premise that free-market competition really can't do the job of protecting consumers. Two decades of economic and public-choice research now exists to prove that the unhindered market works better than any regulators. The other category is the health and safety agencies like the Food and Drug Administration, the FAA protecting against unsafe pilots and unsafe planes, and OSHA for unsafe work places. These basically address an insurance problem and a liability problem. These problems are difficult and very real, but a government regulatory agency is not the only solution to them—not even the best solution. Evidence exists that the insurance industry, if the government doesn't get in and try to do the job for them, will in fact have very strong incentives to set up private testing organizations and private information-collecting and disseminating organizations so as to do this kind of job on their own.

Markets Do It Better

Once you can show people those alternatives really exist, that you're not talking about leaving people to the mercy of quacks and fly-by-night operators that put out unsafe products, then you can show how we don't need to have these government agencies. We can indeed provide decentralized marketplace alternatives that do those same jobs and do them better.

In summary, I have argued that there are several practical ways in which we can begin right now to shrink government back toward its proper role as a protector of rights and to revitalize the voluntary processes of the free society.

We can start reducing the burden of government by cutting its tax take in ways that restore incentives for hard work and risk-taking. Since this requires cutting government spending, we next have to get serious about privatization, based on the realization that the majority of functions government now performs are not public goods at all and could be done better and cheaper by private firms to begin with. Finally, deregulation completes the picture, removing both anti-competitive laws, regulations, and agencies which restrict employment opportunities and consumer choice, *and* the inefficient centralized health and safety agencies which do their job but at a high price in red tape and bureaucratic overhead, where decentralized mechanisms via changed incentives could do the job instead.

Making major changes in these three areas would indeed lead to rebuilding what we now call, with our tongue properly in cheek, "the private sector."

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